Ideal Steel Supply Corp. v. *Anza*: The Second Circuit Clarifies The Proximate Cause Requirement of a Civil RICO Action Under 18 U.S.C. § 1962(a)

On June 28, 2011, the United States Court of Appeals for the Second Circuit issued the latest in a series of decisions in *Ideal Steel Supply Corp.* v. *Anza*,[1] interpreting the proximate cause requirement in civil actions under the Racketeer Influenced and Corrupt Organizations Act ("RICO").[2] On remand from the Supreme Court, the district court had dismissed, for lack of proximate cause, Ideal's claim under 18 U.S.C. § 1962(a) that it had "lost business as a result of defendants' investment of funds, derived from a pattern of racketeering activity, in the establishment and operation of a commercial enterprise in competition with plaintiff's business."[3] The Supreme Court had previously dismissed the portion of the RICO claim brought under 18 U.S.C. § 1962(c) for want of proximate causation but had indicated that "it is at least debatable" whether the same proximate causation standards applied under § 1962(a). In reversing the district court's decision on remand, the Second Circuit concluded that the causation standards under the two subsections are indeed different, and it held that a claim was stated under § 1962(a) notwithstanding the previous dismissal of the claim under § 1962(c).[4]

I. Facts and Procedural History

Ideal Steel Supply Corp. sells steel mill products and related hardware and services in Queens and the Bronx. It asserted civil RICO claims against its competitor, National Steel Supply, Inc., and National's owners, Joseph and Vincent Anza, under both § 1962(a) and § 1962(c). The underlying pattern of racketeering activity was alleged to be sales tax fraud — that defendants had committed mail and wire fraud by "not charging sales tax to any customers who paid for their purchases in cash (the 'cash-no-tax' scheme)" and "then submitting, by mail and wire, fraudulent sales and income tax reports and returns . . . thereby evading substantial sums in [sales and] income tax."[5] Ideal alleged that the Anzas' operation of National through this pattern of racketeering activity violated § 1962(c) and injured Ideal's business by luring away customers who preferred not to pay sales tax. Ideal also alleged that the defendants violated § 1962(a) by investing funds derived from the cash-no-tax scheme at National's Queens location to open a new store in the Bronx, thereby causing Ideal "to lose a substantial amount of business at its Bronx store."[6]

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1 No. 09-3212-cv (2d Cir. June 28, 2011) (Kearse & Walker JJ; Cabranes J, dissenting), available at http://www.ca2.uscourts.gov/decisions/isysquery/799fd4a6-fdd8-493d-809b-e9b312984dcc/26/doc/09-3212_complete_opn.pdf#xml=http://www.ca2.uscourts.gov/decisions/isysquery/799fd4a6-fdd8-493d-809b-e9b312984dcc/26/hilite/ Citations are to the pages of the opinion (the "Opinion").

2 18 U.S.C. §§ 1961-1968.

3 Opinion at 1.

4 18 U.S.C. § 1962(c) provides: "It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt." 18 U.S.C. § 1962(a) states, in relevant part: "It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce."

5 Opinion at 4.

6 *Id.* Ideal's complaint also included "a state-law claim for breach of an agreement that settled prior litigation between Ideal and National." Opinion at 4-5.

On the action's first trip through the courts, the district court (*Ideal I*[7]) had dismissed both RICO claims on the ground that proximate causation in RICO claims based on mail or wire fraud requires that *plaintiff* be the entity that relies on the fraudulent mailings or wire transmissions, and Ideal did not and could not allege that *it* had relied on the sales tax returns the defendants to the State of New York.[8] The Second Circuit reversed, however (*Ideal II*[9]), holding that even if an alleged scheme "depended on fraudulent communications directed to and relied on by a third party rather than the plaintiff," a plaintiff injured in its business or property has standing to pursue a civil RICO claim — and adequately pleads proximate cause — if the factual allegations in its complaint indicate that "the defendant engaged in a pattern of fraudulent conduct that is within the RICO definition of racketeering activity and that was intended to and did give the defendant a competitive advantage over the plaintiff."[10] Because Ideal had alleged that it was directly targeted by and was the principal intended victim of the defendants' scheme, the Second Circuit concluded that Ideal's complaint adequately stated claims under both § 1962(c) and § 1962(a).[11]

In 2006, in *Ideal III*,[12] the Supreme Court reversed in part and vacated and remanded in part. The Second Circuit's holding sustaining the § 1962(c) claim was reversed; the Supreme Court reiterated the proximate cause requirements adumbrated in *Holmes* v. *Securities Investor Protection Corp.*[13] and explained that the relevant inquiry is "whether the alleged violation led directly to the plaintiff's injuries,"[14] rather than whether the violation intentionally targeted the plaintiff. The compensable injury arising from a violation of § 1962(c) "necessarily is the harm caused by predicate acts sufficiently related to constitute a pattern, for the essence of the violation is the commission of those acts in connection with the conduct of an enterprise."[15] There was no direct connection between the defendants' alleged mail and wire frauds and the injury claimed by Ideal, since the direct victim of the defendants' actions was New York State, which lost tax revenue, whereas Ideal's asserted harms were caused by "a set of actions (offering lower prices) entirely distinct from the alleged RICO violation (defrauding the State)."[16] Any less direct correlation between the alleged RICO violation and the plaintiff's asserted injury, the Court said, would make it difficult to determine the amount of a plaintiff's damages attributable to the violation as opposed to various other, independent factors.[17] Here, National could have reduced its prices for reasons unrelated to the asserted fraud, and its lowering of prices did not require it to defraud the state tax authority. Similarly, a company's commission of tax fraud does not necessarily mean the company will lower its prices, and Ideal's lost sales could in any event have stemmed from factors unrelated to National's alleged fraudulent acts. Explaining that "[t]he element of proximate causation recognized in *Holmes* is meant to prevent these types of intricate, uncertain inquiries from overrunning RICO litigation," the Supreme Court reversed *Ideal II* to the extent it had overturned the district court's dismissal of the claim under § 1962(c).[18] The Court did not rule substantively on the claim under

7 *Ideal Steel Supply Corp.* v. *Anza*, 254 F. Supp. 2d 464 (S.D.N.Y. 2003).

8 *Id*. at 468.

9 *Ideal Steel Supply Corp.* v. *Anza*, 373 F.3d 251 (2d Cir. 2004).

10 *Id*. at 263.

11 *Id*. at 264.

12 *Anza* v. *Ideal Steel Supply Corp.*, 547 U.S. 451 (2006).

13 503 U.S. 258 (1992).

14 547 U.S. at 460-61.

15 *Id*. at 457 (quoting *Sedima, S.P.R.L.* v. *Imrex Co.*, 473 U.S. 479, 497 (1985)) (internal quotation marks omitted).

16 *Id*. at 458.

17 *Id*.

18 *Id*. at 459-60.

§ 1962(a), since both *Ideal II* and the parties' arguments in the Supreme Court had focused principally on the § 1962(c) claim. In remanding the § 1962(a) claim for further consideration, however, the Supreme Court did note that "[b]ecause § 1962(c) and § 1962(a) set forth distinct prohibitions, it is at least debatable whether Ideal's two claims should be analyzed in an identical fashion for proximate-cause purposes."[19]

On remand to the district court, Ideal filed an amended complaint, reasserting only its § 1962(a) claim (and its state-law breach of contract claim). The complaint again described the cash-no-tax scheme at National's Queens store and the accompanying mail and wire frauds that permitted defendants' tax evasion and retention of unreported profits, and it alleged that the defendants used those unlawful profits to finance the opening of National's Bronx facility to compete with Ideal.[20] Ideal alleged that prior to the establishment of National's store in the Bronx, no companies were capable of competing with Ideal in the Bronx. The plaintiff asserted that the opening of National's Bronx store caused it injury by (1) simply offering comparable products and services to those offered by Ideal, thus taking customers from Ideal and causing Ideal's annual sales to drop by about one-third, and (2) using the same cash-no-tax scheme that National used at its Queens location, thus allowing National to lure "Ideal's customers with the lower prices their tax fraud financed."[21]

The district court, in *Ideal IV*, granted the defendants' motion for judgment on the pleadings and in the alternative, for summary judgment, finding persuasive the argument that Ideal could not demonstrate that its lost sales were proximately caused by the opening of National's Bronx store through the alleged investment of racketeering activity proceeds. Ideal appealed, and the Second Circuit reversed.

II. The Second Circuit's Decision

The Second Circuit took issue with the procedural aspects of the district court's decision, particularly with its choice to apply *Twombly*[22] pleading standards in the face of a fully developed factual record,[23] but the crux of its decision was a substantive determination that losses from competition enabled by the proceeds of racketeering activity *can* constitute injury proximately caused by the investment of such proceeds and are, thus, compensable in a private civil RICO action alleging violations of § 1962(a). Whereas § 1962(c), which was the principal focus of *Ideal I*, *II*, and *III*, prohibits "any person employed by or associated with a commerce-affecting enterprise 'to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity,'"[24] so that the "compensable injury" under § 1962(c) is "'the harm caused by predicate acts sufficiently related to constitute a pattern,'"[25] the prohibitions under § 1962(a) are different and so, therefore, are the types of harm that may be compensated.

Under § 1962(a), "[a]fter there have been sufficient predicate acts to constitute" a pattern of racketeering activity, "what is forbidden . . . is the investment or use of the proceeds of that activity to establish or operate a

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19 *Id*. at 461-62.

20 *Ideal Steel Supply Corp.* v. *Anza*, No. 02 Civ. 4788, 2009 WL 1883272, at *2-3 (S.D.N.Y. June 30, 2009).

21 *Id*. at *3. *See also* Opinion at 11-13.

22 *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544 (2007).

23 Opinion at 27-31.

24 *Id*. at 20 (quoting 18 U.S.C. § 1962(c)). The Second Circuit uses the term "commerce-affecting enterprise" to refer to an "'enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.'" *Id*. (quoting 18 U.S.C. § 1962(a)).

25 *Id*. (quoting *Ideal III*, 547 U.S. at 457 (quoting *Sedima*, 473 U.S. at 497)) (internal quotation marks omitted).

commerce-affecting enterprise."[26] Accordingly, the injury needed for a claim under § 1962(a) is not that caused by the predicate acts constituting the pattern of racketeering activity but only that caused by the *use or investment* of the proceeds of those acts. Under § 1962(a) "both the funds derived 'directly or indirectly' from" a pattern of racketeering activity "and the 'proceeds of such income' are tainted: no part of the 'income, or the proceeds of such income' may lawfully be 'use[d] or invest[ed],' whether 'directly or indirectly,' in 'the establishment or operation' of" the enterprise.[27] Moreover, the "numerous disjuncts" in § 1962(a) indicate that "any of dozens of combinations or permutations will constitute a violation of that section."[28] Citing the oft-repeated Supreme Court admonition that "RICO is to be read broadly,"[29] the Second Circuit rejected the defendants' assertion that § 1962(a) does not prohibit the reinvestment of ill-gotten proceeds in the same entity that engaged in the racketeering activity, and, thus, that their use of racketeering proceeds to open National's Bronx store did not constitute a violation at all. The Court reasoned that (1) the defendants did not merely reinvest in the same entity, since the defendants created a new corporation to purchase the property for National's Bronx store, and (2) the legislative history does not allow an inference that Congress intended to allow, with impunity, entities engaged in racketeering activity to use funds derived from such activity to branch out to new locations.

Having determined that the "proper referent" in the proximate cause analysis under § 1962(a) is the defendants' use or investment of the racketeering proceeds to establish or operate National's facility in the Bronx, the Court turned to Ideal's evidence that the opening and operation of National's Bronx location, and the resulting competitive injury to Ideal, were proximately caused by such use or investment.[30] The district court had pointed to various possible intervening factors in entering summary judgment for defendants, but the Second Circuit held that none of those factors justified judgment as a matter of law against Ideal.

The Second Circuit's central holding was that the proximate cause inquiry for § 1962(a) claims is *not* the same as that for claims under § 1962(c); conflating the two inquiries, as the district court had done, ignores the "different referents required by the different prohibitions."[31] Per the Supreme Court in *Ideal III*, Ideal's § 1962(c) claim lacked the proximate cause element because "the cause of Ideal's harm was 'a set of actions (offering lower prices) entirely distinct from the alleged RICO violation (defrauding the State).'"[32] With respect to the claim under § 1962(a), however, the act constituting the defendants' alleged violation — the use or investment of the defendants' racketeering activity funds to open and operate National's Bronx store — is the very act that caused Ideal's lost sales. In effect, the Court held that Ideal was entitled to try to prove that the *very existence* of National's Bronx location caused Ideal's injury. The decisions of individual purchasers did not constitute intervening acts, because once the new store opened, Ideal was bound to lose *some* business. Given this perspective, none of the district court's proffered "intervening" causes sufficed to break the chain of proximate causation for summary judgment purposes:

- The assertion that Ideal might have lost business due to inferior products raised a question of "but for" causation, not proximate causation, and was thus an issue of fact for the jury, par-

26 *Id*.

27 *Id*. at 21 (quoting 18 U.S.C. § 1962(a)) (brackets in original).

28 *Id*.

29 *Id*. (quoting *Sedima*, 473 U.S. at 497-98).

30 *Id*. at 23-24.

31 *Id*. at 33.

32 *Id*. (quoting *Hemi Group, LLC* v. *City of New York*, 130 S. Ct. 983, 990 (2010) (describing and quoting *Ideal III*, 547 U.S. at 458)) (internal quotation marks omitted).

ticularly since the record, when viewed in the light most favorable to Ideal, "did not compel the court's inference as a matter of fact."[33]

- The suggestion that Ideal might have lost sales due to competition from other local steel companies had no basis in the record.
- The district court's implication that Ideal may have lost sales due to its business decision not to lower its prices to match those of National "seems to have lost sight of the alleged RICO violation, *i.e.*, the investment of racketeering activity funds to establish the National facility in the Bronx," since absent the investment, "there would have been no National prices for Ideal to match."[34]

Accordingly, the Second Circuit reversed the judgment of dismissal and remanded the matter for trial.

III. The Dissent

The dissent did not dispute that the "proper referent" for the proximate cause analysis under § 1962(a) is different from that under § 1962(c), but argued that "the relation between the injury asserted and the injurious conduct alleged in Ideal's § 1962(a) claim is, like its § 1962(c) claim, too remote and speculative to satisfy the necessary proximate-cause analysis."[35] While the Bronx store may not have existed but for the alleged investment of ill-gotten proceeds, "it may also be that the economic projections concerning the development of a National facility in the Bronx were so promising, and access to abundant capital so cheap, that the decision to open the Bronx store was unaffected . . . by whatever ill-gotten proceeds were available."[36] Even if a court could unravel these intertwining strands, which the dissent felt was "doubtful," it would be impossible to determine the precise injury to Ideal due to any impact of the ill-gotten investment on the operation of National's Bronx facility.[37] These are the types of "intricate, uncertain inquiries" that the element of proximate causation recognized in *Holmes* intended to prevent.[38] Moreover, if companies "can pursue civil RICO claims against their competitors on the basis of allegations that ill-gotten proceeds have funded perfectly legitimate and competitive pursuits, RICO can be misused as a weapon against competition in the marketplace."[39]

IV. The Significance of the Decision

Although there are numerous decisions dismissing claims under § 1962(a) for want of "investment injury," decisions actually sustaining such claims are extremely rare.[40] The Second Circuit's decision in *Ideal V* is by far the most authoritative analysis of the causation and injury requirements under that subsection yet to appear.

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33 *Id*. at 35.

34 *Id*. at 36.

35 *Id*., dissenting opinion, at 3 (quoting *Ideal III*, 547 U.S. at 462 (quoting *Holmes*, 503 U.S. at 268)) (internal quotation marks omitted).

36 *Id*., dissenting opinion, at 5.

37 *Id*.

38 *Id*.

39 *Id*.

40 A useful survey as of 2006 appears in *Kmart Corp.* v. *Areeva, Inc*., Civil Case No. 04-40342, 2006 WL 2828572 (E.D. Mich. Sept. 29, 2006). There are less than five such subsequent decisions of any significance.

If it survives (or is spared) another trip to the Supreme Court, it will be the leading decision on causation and injury under § 1962(a) for years to come.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Edward P. Krugman at 212.701.3506 or ekrugman@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Yafit Cohn at 212.701.3089 or ycohn@cahill.com.